

REQUEST FOR APPROVAL

To: Scott Smithline
Director

From: Howard Levenson
Deputy Director, Materials Management and Local Assistance Division

Request Date: September 19, 2017

Decision Subject: Consideration of the California Used Mattress Recovery and Recycling
2018 Program Budget

Action By: September 30, 2017

Summary of Request:

The Mattress Recycling Council (MRC) submitted the 2018 Used Mattress Recovery and Recycling Plan Budget (2018 Budget) to CalRecycle on June 30, 2017, with a revised Budget submitted on August 11, 2017. As directed by the Used Mattress Recovery and Recycling Act, CalRecycle must approve or disapprove the Budget on or by October 1, 2017. Pursuant to Public Resources Code § 42989, the mattress recycling organization shall set the amount of the mattress recycling charge and the charge shall be included in the annual program budget for approval by the Department. The MRC's Proposed 2018 Budget includes a reduction to the current mattress recycling charge, for which the MRC has provided the appropriate public notice.

CalRecycle staff reviewed the 2018 Budget and determined it has met the statutory requirements of the Act, as well as the regulatory requirements of California Code of Regulations (CCR) § 18963. This item requests the Director's approval of the Budget.

Options:

1. Approve the MRC's proposed 2018 Budget and mattress recycling charge reduction. The new mattress recycling charge of \$10.50 per unit will become effective January 1, 2018.
2. Disapprove the MRC's proposed 2018 Budget, including the proposed mattress recycling charge reduction, and request that the MRC resubmit a revised Budget to CalRecycle within 30 days that addresses the concerns contained in this Request for Approval.

Recommendation:

Staff recommend Option 1, approval of the MRC's proposed 2018 Budget and reduction of the mattress recycling charge from \$11.00 per unit to \$10.50 per unit effective January 1, 2018. Staff further recommend the MRC provide additional detail in the proposed budget for calendar year 2019 and subsequent years with a line item breakdown of anticipated expenditures for each activity within each of the cost categories, as described within this Request for Approval. Staff also recommend that the MRC consider specific issues raised by staff and stakeholders (e.g., regarding research, illegal dumping, and market development) and report in the MRC's 2017

Annual Report whether the MRC considers that programmatic changes related to these issues are warranted.

Action:

On the basis of the information and analysis in this Request for Approval, and the findings set out above, I hereby approve the 2018 Used Mattress Recovery and Recycling Budget submitted by the MRC on August 11, 2017, including the reduction of the mattress recycling charge from \$11.00 per unit to \$10.50 per unit effective January 1, 2018. In addition, I request the MRC to consider providing additional detail in the proposed budget for calendar year 2019 and subsequent years with a line item breakdown of anticipated expenditures for each activity within each of the cost categories, as described further below. I further request that the MRC consider specific issues raised by staff and stakeholders regarding research, illegal dumping, and market development, and that it report in the 2017 Annual Report whether programmatic changes related to these issues are warranted.

Dated: 9-21-17



Scott Smithline, Director

Attachments:

1. Used Mattress Recovery and Recycling Budget Cover Letter; available at: <http://www.calrecycle.ca.gov/Mattresses/Plans/2018BudLtrUp.pdf>
 2. 2018 Used Mattress Recovery and Recycling Plan Budget, updated August 10, 2017; available at: <http://www.calrecycle.ca.gov/Mattresses/Plans/2018BudgetUp.pdf>
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BACKGROUND

Senate Bill (SB) 254 (Chapter 388, Statutes of 2013) established the Used Mattress Recovery and Recycling Act (Act). Subsequently, the Governor signed SB 1274 (Chapter 371, Statutes of 2014), which provided additional clarity regarding definitions, report submittals, and record keeping requirements under the Act.

The Act requires implementation of the Used Mattress Recovery and Recycling Program (Program) in order to reduce illegal dumping, increase recycling, and substantially reduce public agency costs for the end-of-life management of used mattresses. Mattress manufacturers, via a mattress recycling organization, are required to develop, finance, and implement a convenient and cost-effective Program, which is consistent with the state's solid waste management hierarchy, to recover and recycle used mattresses generated in California. A mattress recycling organization must be certified by CalRecycle and submit a budget and used mattress recovery

and recycling plan (plan) that details the proposed mattress stewardship Program to the Department. On or before July 1, 2015, and annually thereafter, the mattress recycling organization shall prepare and submit to the department a proposed used mattress recycling program budget for the following calendar year. CalRecycle certified the Mattress Recycling Council (MRC), a non-profit organization created by the International Sleep Products Association, as a mattress recycling organization in November 2014, approved the first Budget in October 2015, and approved the MRC's Plan in January 2016. CalRecycle recently (August 22, 2017) conditionally approved the 2016 Annual Report, citing several required changes in the 2016 Annual Report as well as suggested changes in programmatic activities and future Annual Reports.

In accordance with the Act, and in order to develop a statewide mattress recycling system several times larger than what previously existed in California, the MRC calculated a "funding level sufficient to cover the plan's budgeted costs and to operate the mattress recycling program over a multiyear period in a prudent and responsible manner." The MRC estimated both the costs and revenues that it expected to realize over the 2016-2018 time period. Beginning on December 30, 2015, an \$11.00 recycling charge (the only source of revenue for the Program) was set for all new and renovated mattresses and foundations sold in the State.

STAFF ANALYSIS AND RECOMMENDATIONS

The MRC's proposed 2018 Budget is based on actual revenue and expenses from 2016 and year-to-date (YTD) 2017 (through May 31, 2017), with adjustments for anticipated changes in 2018. The MRC's primary source of revenue is from the mattress recycling charge collected on each unit sold. Expense categories include collection, transportation and processing, communications, research, administrative expenses, and CalRecycle oversight.

Anticipated Revenues

The MRC based its 2016 and 2017 Budgets on best estimates and forecasts following national sales trends in the absence of California-specific sales data. For the purposes of the 2018 Budget, the MRC started with 2016 actual sales data (row 1 in table below) and reduced the projected 2017 sales forecast by 4.4% based on the difference in sales nationally between Quarter 1 2017 compared with Quarter 1 2016 (row 2). For its 2018 projection, the MRC then increased the adjusted 2017 sales forecast by 3% (row 3), which was the expected national growth rate provided by ISPA's 2016-2018 mattress industry forecast. Staff note that the MRC used this adjustment increase of 3% even though the actual sales in the previous year were down 4.4%.

2016 Actual California Units Sold	3,842,046
Adjusted 2017 Budget Forecast for California Units Sold (2016 Actual – 4.4%)	3,672,996
2018 Budgeted California Units Sold (Adjusted 2017 + 3.0%)	3,783,186

While California-specific sales data is limited, the MRC states that actual 2017 Quarter 1 California unit sales were 11% below budget. Additionally, Quarter 2 national sales data

dropped by 8%, according to data published in BedTimes in Brief¹, an industry publication. Staff believe that the budget ultimately should be based on California sales data. In the interim, staff recognize the utility that national sales trends provide until such time as California sales trends are established. Staff anticipate that the MRC will base the 2019 and future revenue projections primarily on actual California sales data and trends to allow for more accurate projections over time.

Anticipated Expenses

The MRC provided a breakdown of expenses from Program implementation through May 31, 2017 (YTD 2017). The MRC notes that 2016 actual expenses were far below projections due to fewer units being collected than anticipated. The itemization of the proposed 2018 Budget cost categories compared to the 2016 actual expenses is as follows:

MRC Cost Category	Percent of Total Costs			Amount Per Cost Category	
	2016 (from approved Budget)	2016 (Actual ₂)	2018 (as proposed)	2016 (Actual expenses)	2018 (as proposed)
Collection	10.2%	9%	13%	\$1,640,002	\$4,265,844
Transportation & Processing	72.8%	60%	65%	\$10,477,301	\$21,594,792
Communication Expenses	3.1%	8%	10%	\$1,394,990	\$3,307,981
Research Expenses	11.5%	12%	1%	\$2,004,445	\$278,000
Administration Expenses			9%		\$2,932,681
California Oversight	2.5%	11%	2%	\$1,853,965 ₁	\$700,000
Total	100%	100%	100%	\$17,370,703	\$33,079,299

Note 1: CA Oversight expenses incurred from 2013-2016

Note 2: 2016 Actual Percent of Total Costs are based on CalRecycle calculations

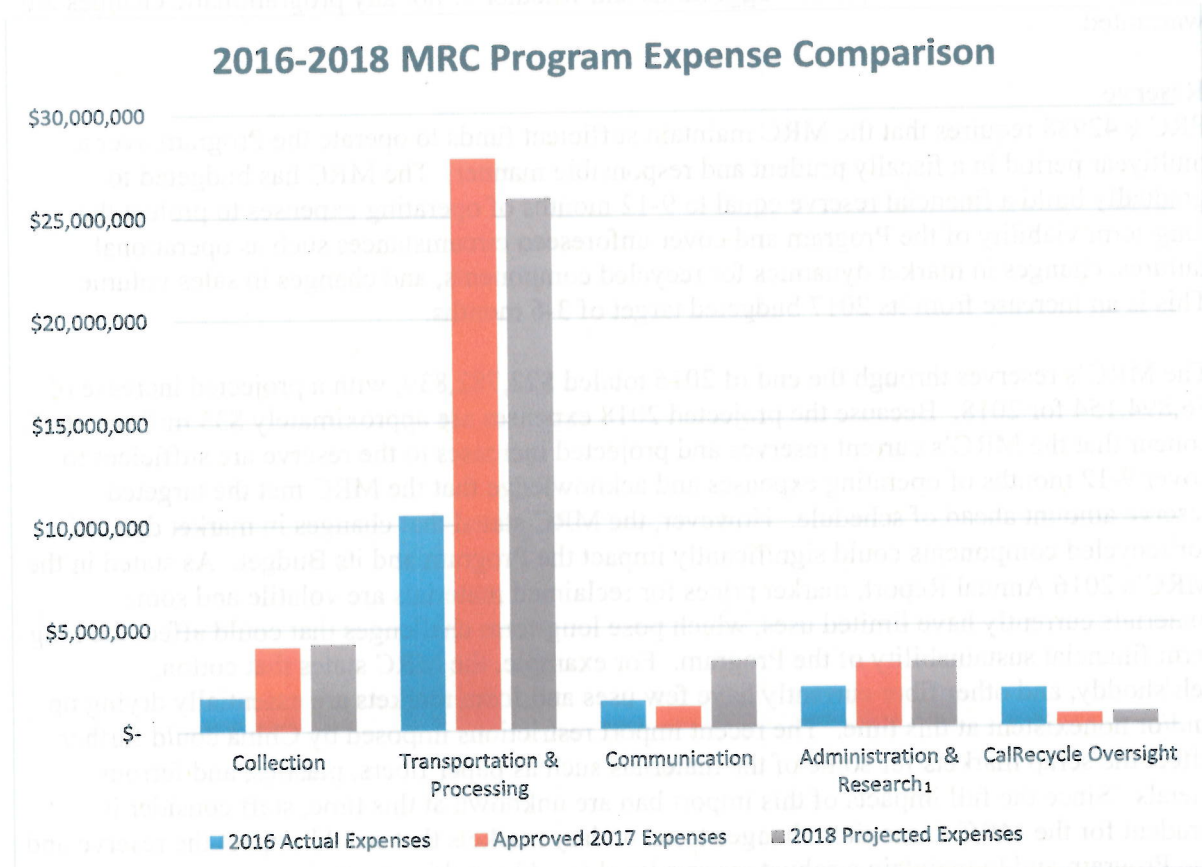
The MRC projects that the number of units collected will increase by 30% in 2017 and an additional 15% in 2018. As a result, the proposed 2018 Budget anticipates an increase in expenses as the Program expands. The collection, transportation, and processing categories include an inflation factor of 3% and a contingency factor for unforeseen costs as the Program expands. The Budget does not identify the size of the contingency factor. The proposed 2018 Budget also includes a 65% increase in education and outreach expenses over the 2017 budgeted amount in order to continue statewide outreach efforts to promote Program awareness. CalRecycle staff consider the projected increases in expenses as reasonable for the MRC to meet its anticipated Program expansion goals and will be reviewing/evaluating MRC's progress in meeting the expected growth during the Annual Report compliance reviews.

However, stakeholders have suggested (see last section of this document) that increased funding and activities are needed in communication, illegal dumping prevention, and incentives to consumers and solid waste facilities. Staff request that the MRC include a discussion in its next Annual Report about the above stakeholder suggestions and consider whether or not any

¹ <http://bedtimesmagazine.com/2017/08/2nd-quarter-mattress-sales-revenues/>

programmatic changes are warranted. In addition, CalRecycle staff continue to believe that more information is needed about proposed expenditures in order to ascertain whether specific programmatic activities are being effectively implemented. Without more detailed budget information, it is difficult to ascertain whether or not additional funding for these types of activities is needed.

Staff recommend that the MRC include separate proposed line item expenditures for the research cost category and identify the amount of the budget allocation to any cost category that is considered contingency funds in the 2019 Budget and subsequent budgets.



Note: 1 Research and Administration costs are separate in the above Table, but combined here because the MRC did not provide actual line item expenses for Research in 2016-2017

Research

CalRecycle requested in its October 1, 2015 Request for Approval that the MRC separate administration, research, and advisory costs in future budgets into individual subcategories and include line item costs. For example, the research category would be expected to include anticipated costs for each specific research task that will be performed in the following calendar year, such as researching alternatives for removing steel from pocketed coil innersprings or developing end use markets for specific recycled mattress components. While the proposed 2018 Budget includes a line item for research, it does not delineate costs for each task or activity and does not include actual 2016 expenses for research. For future Budgets, staff again request

the MRC provide cost breakdown for each anticipated task or activity and provide actual expenses related to research.

Additionally, the MRC Advisory Committee suggested that increasing market development expenditures, including renovation and design efforts, could help contracted recyclers reach diversion targets and find productive uses for the 36% of the materials rejected. While the MRC has indicated that it cannot control secondary markets or how manufacturers make their products, staff agree with the Advisory Committee that further consideration of this issue is warranted. Staff recommend that the MRC include a discussion in its next Annual Report about these research and market development suggestions and whether or not any programmatic changes are warranted.

Reserve

PRC § 42988 requires that the MRC maintain sufficient funds to operate the Program over a multiyear period in a fiscally prudent and responsible manner. The MRC has budgeted to gradually build a financial reserve equal to 9-12 months of operating expenses to protect the long-term viability of the Program and cover unforeseen circumstances such as operational failures, changes in market dynamics for recycled components, and changes in sales volume. This is an increase from its 2017 budgeted target of 3-6 months.

The MRC's reserves through the end of 2016 totaled \$22,782,839, with a projected increase of \$6,894,154 for 2018. Because the projected 2018 expenses are approximately \$33 million, staff concur that the MRC's current reserves and projected increases to the reserve are sufficient to cover 9-12 months of operating expenses and acknowledge that the MRC met the targeted reserve amount ahead of schedule. However, the MRC stated that changes in market dynamics for recycled components could significantly impact the Program and its Budget. As stated in the MRC's 2016 Annual Report, market prices for reclaimed materials are volatile and some materials currently have limited uses, which pose long-term challenges that could affect the long-term financial sustainability of the Program. For example, the MRC states that cotton, felt/shoddy, and other fiber currently have few uses and foam markets are essentially drying up and/or nonexistent at this time. The recent import restrictions imposed by China could further effect the scrap markets for some of the materials such as paper fibers, plastics, and ferrous metals. Since the full impacts of this import ban are unknown at this time, staff consider it prudent for the MRC to monitor changes to secondary markets that would impact the reserve and the Program and to maintain a robust reserve level to address this uncertainty.

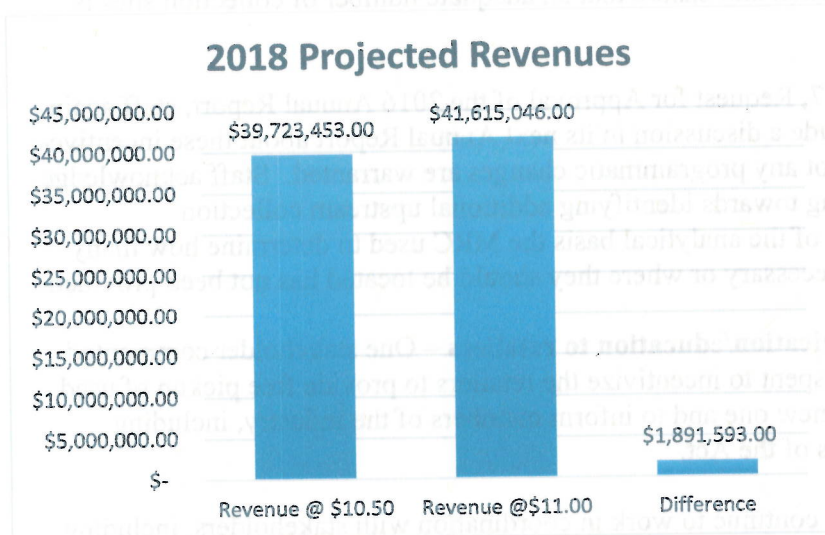
Amount of Mattress Recycling Charge

The MRC proposes to reduce the mattress recycling charge to \$10.50 per unit beginning January 1, 2018, stating that the 2018 Budget is sufficient to fund Program expansion and build a reserve covering 9-12 months of operating expenses.

As noted below (see Stakeholder Comments), all stakeholder comments opposed the proposed reduction to the mattress recycling charge.

While staff believe that it may be premature to lower the mattress recycling charge after only a year and a half of Program implementation, the MRC's proposed 2018 Budget meets the

statutory requirements of the Act as well as the regulatory requirements of California Code of Regulations § 18963 necessary for Budget approval. Further, staff note that the difference in the proposed reduction from \$11.00 to \$10.50 per unit represents less than \$2 million in projected revenues for 2018 and staff is not able to conclude that \$10.50 per unit is insufficient to cover the budgeted costs to operate the mattress recycling program.



STAKEHOLDER COMMENTS

CalRecycle received six comment letters and two public comments from stakeholders regarding the MRC's Proposed 2018 Budget. A complete list of comments as submitted by stakeholders is located online at: <http://www.calrecycle.ca.gov/Mattresses/Plans/default.htm>. All comments opposed the proposed reduction to the mattress recycling charge. The comments covered a range of topics, including:

Undue burden to small businesses and confusion at the point of sale – One stakeholder from an organization that operates multiple charity thrift stores commented that a recycling fee that is not an even amount will require them to purchase more sophisticated equipment to apply the charge at the point of sale. The business is a small, non-profit organization that does not have the ability to automatically apply the fee at the register since invoices are currently processed manually, and therefore, a new, half dollar amount will create confusion for the employees leading to them potentially forgetting to collect the fee as opposed to a whole dollar amount.

Staff underscore the importance of effective outreach and communication to both retailers and consumers to avoid potential confusion over the proposed reduction to the mattress recycling charge. Staff recommend that the MRC monitor the impact of a half-dollar reduction to the mattress recycling charge on compliance of the fee remittance at retail locations.

Premature to lower the fee when significant gaps in collection activity and Program participation exist – Several stakeholders, most notably local governments' representatives from the East Bay area and the Mattress Advisory Committee, commented that there has been

little perceptible impact to illegal dumping and that the level of convenience for some areas of the state is not yet adequate. The Advisory Committee commented that as the Program matures, expenditures would be expected to steadily increase while revenues would maintain close to the current level, therefore reducing the reserve to a more prudent level. Additionally, stakeholders recommended increasing the consumer incentive and increasing the payments to solid waste facilities to encourage participation and ensure that an adequate number of collection sites is achieved.

As noted in the August 22, 2017, Request for Approval of the 2016 Annual Report, staff again recommend that the MRC include a discussion in its next Annual Report about these incentive-related issues and whether or not any programmatic changes are warranted. Staff acknowledge that the MRC is already working towards identifying additional upstream collection opportunities, but a description of the analytical basis the MRC used to determine how many additional collection sites are necessary or where they should be located has not been provided.

Additional funds for communication/education to retailers – One stakeholder commented that additional funds should be spent to incentivize the retailers to provide free pickup of used mattresses when they deliver a new one and to inform members of the industry, including retailers, about the requirements of the Act.

Staff recommend that the MRC continue to work in coordination with stakeholders, including retailers, and the Department to ensure all of the targeted audience is aware of the Program and its requirements and that current communication methods are effective.

Budget transparency requests – The Advisory Committee sought details regarding the “broad categories of spending” for collection, transportation, and recycling and would like the MRC to specifically identify groups of recipients, i.e. retailers, manufacturers, private waste facilities, private collectors, and public agencies for those costs. The Advisory Committee would also like to know how much was spent on research and development and on market development. The MRC Advisory Committee also requested the MRC provide more cost detail in relation to CalRecycle Oversight expenses.

CalRecycle staff agree with these suggestions and recommend that the MRC include separate proposed line item expenditures for the research cost category and provide additional detail about these expenses in the 2019 Budget and subsequent Budgets.

Determination of Two Separate Charges

PRC § 42989(b)(2) gives MRC the discretion to either set a single recycling charge that applies to all sizes and types of mattresses and foundations, or set up two different charges to accommodate mattress size differentials. In the past, stakeholders and the Advisory Committee expressed concern over the impact of a single charge on lower income individuals. Additionally, CalRecycle requested (in the October 1, 2015 Request for Approval) that the MRC evaluate and consider the impact of two separate charges and consult with the Advisory Committee. The MRC has determined that a single charge for all units is appropriate based on the following reasons: a single charge is simple to communicate to consumers, retailers, and other stakeholders; a single charge has simplified the reporting process and minimized compliance

errors by retailers; the net cost to recycle a smaller mattress is more than a larger unit because the scrap value reclaimed from a smaller mattress is less than the value from a larger mattress; and the size of mattresses purchased is often different than the size of mattresses discarded.

